



Tax Policy & Research
Sam W. Mitchell Building

Montana Department of
REVENUE

P. O. Box 5805
Helena, Montana 59604-5805

DATE: October 5, 2001

TO: Governor's K-12 Public School Funding Advisory Council

FROM: Judy Paynter, Tax Policy and Research Process Leader

SUBJECT: **HB124 Block Grants for Schools**

This report provides information to the Public School Funding Advisory Council so that an informed decision can be made on the primary question of "Should an alternative funding method for distributing HB124 block grant funds to schools be developed by the Council?" Background on tax reimbursement programs and the HB124 school block grants is provided. A conclusion is drawn based on the background provided, and questions are posed for the Council's deliberation.

Background

There are three school block grants in HB124: (1) the school district block grants, (2) the countywide retirement block grants and (3) the countywide transportation block grants. HB124 retains five revenue sources at the state and replaces them with a single payment to the school districts for each type of block grant.

The two major revenue sources retained are motor vehicle revenue and previous tax reimbursements in SB184. Table 1 shows the revenue sources and the growth rate for the schools block grant. The school block grant covers all school budgets that have property tax, excluding the countywide retirement and transportation programs. Of the \$57 million dollar block grant, \$24 million or 42% is from tax reimbursements, and \$29 million or 51% is from motor vehicle revenue. The other \$4 million is Financial Institution Corporate License Tax, Payments in Lieu of Taxes (PILT) made by the Department of Natural Resources and Conservation, and state aeronautics fees. HB124 continues the current rate of growth for fiscal 2002 and 2003 for the school block grants. The overall rate of growth for these funds is 0.76%.

Table 1
Comparison of Current Law Revenue Flow and HB124 School Block Grants

Revenue Sources	----- 2003 Biennium -----		
	Fiscal 2002	Fiscal 2003	Biennium Total
SB184 Reimbursements	\$ (24,072,153)	\$ (24,072,153)	\$ (48,144,306)
Motor Vehicles - All Other	\$ (29,021,274)	\$ (29,456,593)	\$ (58,477,867)
Financial Institutions Tax	\$ (3,454,946)	\$ (3,454,946)	\$ (6,909,892)
DNRC-PILT	\$ (336,347)	\$ (336,347)	\$ (672,694)
State Aeronautics Fee	\$ (95,229)	\$ (95,229)	\$ (190,458)
Change in Current Law Revenue	\$ (56,979,949)	\$ (57,415,268)	\$ (114,395,217)
HB124 Block Grant	\$ 56,980,850	\$ 57,413,905	\$ 114,394,755
Difference	\$ 901	\$ (1,363)	\$ (462)

Annual Growth Rates

Revenue Sources	Fiscal 2002	Fiscal 2003
SB184 Reimbursements	0.00%	0.00%
Motor Vehicles - All Other	1.50%	1.50%
Financial Institutions Tax	0.00%	0.00%
DNRC-PILT	0.00%	0.00%
State Aeronautics Fee	0.00%	0.00%
Change in Current Law Revenue	0.76%	0.76%
HB124 Block Grant	0.76%	0.76%
Difference	0.00%	0.00%

The block grants are to redistribute the de-earmarked revenue to schools through a two-year reimbursement program, similar to that provided in SB184. Representatives from education associations testified that the Office of Public Instruction, along with members of the Education Forum, would sponsor legislation in 2001 for an interim study of the school funding and equalization formula. Therefore, the committee determined it was not appropriate to make drastic changes in the existing funding formula. Based upon that testimony, the Local Government Funding and Structure Committee decided to establish block grant reimbursements which sunset at the end of fiscal year 2003.

The Local Government Funding and Structure Committee did not build in a growth factor for the block grants because the block grant system is a temporary funding structure. The committee recommended that schools receive the same amount in fiscal years 2002 and 2003. However, the Legislature built in the existing growth rate and added the following language:

Section 252. Coordination with school funding study. If an interim study of school funding is conducted during the interim

commencing July 1, 2001, the study must include recommendations for retaining or repealing the block grants provided for in [sections 244 through 246].

Section 244 is the school district block grants. Section 245 is the countywide school retirement block grants. Section 246 is the countywide school transportation block grants.

HB625 is the school-funding bill passed by the 2001 Legislature. Therefore, this committee needs to consider how to put the revenue included in the three types of school block grants into a rational funding formula(s) for schools. The block grants were not considered to be the appropriate long-term method to distribute the funds to schools by the Local Government Funding and Structure Committee. The 2001 Legislature directed the school study to include recommendations for retaining or repealing the block grants.

Historically, the Legislature has not considered the concept of replacing property tax reductions with block grants to be a rational long-term method of disbursing funds to local governments or schools. The programs referred to as HB20 and SB417, and the sunset of the tax reimbursements in SB184, illustrate this point. These three reimbursement programs were primarily for Class 8 business equipment property tax reductions.

HB20 was a reimbursement program for when the rates were reduced from a high of 16% for selected types of business equipment to 9% for all business equipment. At first this program allowed for reimbursement growth, then the growth was eliminated and the payment levels held flat. Then, the program was determined to be an irrational way to distribute money to local governments and schools for the long-term. Legislators were able to point out communities where businesses that were in existence at the point in time the reimbursement was calculated had closed, and other communities that had obtained substantial new business start-ups. Thus, it was argued that a static method of funding local communities for tax reductions based on historical conditions was not logical. The arguments were persuasive and a ten-year phase-out of the reimbursements was started beginning with fiscal year 1999 payments.

SB417 was a Class 8 business equipment property tax reduction from 9% to 6%. The counties were allowed to withhold property tax money that otherwise would have been sent to the state to make up for the amount of the tax reduction as calculated by the Department of Revenue at a point in time. However, the Legislature found this reimbursement program just as irrational as the HB20 program. The SB417 reimbursements are on the same ten-year phase-out schedule as HB20 reimbursements.

SB184 was established as a two-year reimbursement program for tax cuts enacted during the 1999 Legislature. The majority of the reimbursement was for

SB200 business equipment tax cuts from 6% to 3%. However, the 1999 Legislature did not think putting a third tax reimbursement program in place, which had the same irrational distribution method as HB20 and SB417, was a good long-term program. Therefore, SB184 included language to establish the Local Government Funding and Structure Committee to propose a rational long-term method for distributing funds to local governments and schools. The SB184 reimbursements were sunset June 30, 2001. This emphasized the need for the 2001 Legislature to consider a rational distribution solution.

Conclusion

With this history of the legislature considering block grant reimbursements to not be the appropriate way to fund local government or school programs, and the rationale of the Local Government Funding and Structure Committee of making the fiscal 2002 and 2003 block grants for schools temporary until people knowledgeable about school financing could propose a logical distribution method for schools, the school study should address a more long-term way than block grants for funds to be distributed to school budgets.

Questions

Question 1: Does the Council want to eliminate the block grants and develop a more rational distribution methodology for these funds?

Option A: Yes

Option B: No

Question 2: Would the Council like OPI and OBPP to propose ways to integrate the block grant money into a formula(s) for the various school budgets and the countywide retirement and transportation affected by the block grant funds?

Option A: Yes

Option B: Yes, but we would like to have a discussion to brainstorm ideas for OPI and OBPP to consider when preparing options for the next meeting.

Option C: No